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REPORT OF THE CHAIR

BY AARON H. FOX, ESQUIRE | PENNSYLVANIA TRUST

As many of you know, the Probate and Trust Law Section is made up of nine different Committees, and it is in these Committees where the real work of our Section is done. Without the Committee Chairs and the members of each group who volunteer their time, it is safe to say that the Section could not function. I thought I would use my report this quarter to focus on a few of the activities in which the the Committees are engaged and highlight some of their accomplishments.

The Rules and Practice Committee, co-chaired by Bernice Koplin and Erin McQuiggan, has been hard at work for the past several months on revising our local rules and integrating them with the new state-wide Orphans' Court rules. As Judge Carrafiello mentions in his column this quarter, this was a work-intensive process that required the collaboration of several groups working under a tight deadline. Given the breadth of the changes, the Education Committee, chaired by Amy Quigg, will be organizing a CLE program on this subject later this year.

Although we are less than halfway through the year, The Elder Law and Guardianship Committee has already organized two well-attended panel discussions on topics of interest to the Committee. Co-chairs Anastasia dePaz and Linda Hee are also working with Judge Sheila Woods-Skipper and Judge Carafiello on the Elder Justice Resource Center initiative that began last year. The Center will be located in City Hall and will provide seniors with assistance navigating the court system, as well as educational seminars to prevent physical and financial abuse.

Lastly, the Diversity Committee, led by Chair Licia Ańo-Marrone, has continued with efforts to broaden the diversity of our Section, and our new Diversity and Inclusion Plan can now be found on the Section's webpage. Timothy Holman, a member of the Committee, also participated in a panel discussion with Judge Overton for the Barristers' Association of Philadelphia, as part of our efforts to partner with the various local affinity groups.

continued on page 3

IN THIS ISSUE

03 A View from the Bench

04 Attorney Annual Registration Form: Financial Data Reporting Requirements

09 Ethics Column

11 Tax Update

13 Unbundling of the Financial Regulations Under Section 67: The Deductibility of Trust and Estate Expenses

17 Case Summary from the Orphans' Court Litigation Committee

NEWSLETTER ARTICLES

Would you like to see something in future issues of the Probate and Trust Law Section Newsletter? Then, why don't you write it? If you are interested, please contact the Editor:

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A VIEW FROM THE BENCH

BY THE HONORABLE MATTHEW D. CARRAFIELLO, ADMINISTRATIVE JUDGE | PHILADELPHIA COURT OF COMMON PLEAS, ORPHANS' COURT DIVISION

If any of you have attended a CLE in which I have presented, you've probably heard me say, "It's good to know the law but even better to know the judge." After waiting an appropriate period of time for either the shock or laughter to subside, my explanation usually follows that while seeking preferential treatment because of familiarity or friendship is inappropriate, knowing the Presiding Judge's expectations goes a long way in having a more meaningful and productive courtroom experience.

By now, you have all gotten to know the Judges of Orphans' Court, together with their expectations, however, questions still arise as to why we either do, don't do, permit or don't permit certain conduct. Therefore, let me take a brief opportunity to share with you my perception of the Trust and Estate Bar which comes before me which will help further explain what happens in my courtroom and why. In doing so, I will reveal some very deep feelings about what we do. Please accept these as my sole observations, as I have not collaborated with my Orphans' Court colleagues for this article, even though I may have been influenced by our collegial interchanges.

First, there is a universal high regard for the Trust and Estate Bar, the Probate and Trust Law Section and its members. You are tireless in pursuing issues which affect the interests of those you represent as well as those you don't. The issues of un-representation and under-representation have been addressed in our forum centuries before Gideon v. Wainwright, so that it has become part of the Trust and Estate practitioner's culture.

I am particularly grateful to the Section and its Rules and Practice Committee for their draft of proposed local civil rules concerning the distribution of litigation proceeds in minors', incapacitated persons', and wrongful death and survival actions. With no motivating self-interest, our attorneys overhauled and reintegrated these rules and court regulations so that non-estate attorneys and judges can more easily understand, access, and use them.

Similarly, rather than permit our local Orphans' Court rules to sunset, the Section, through its Rules and Practice Committee, partnered with legal staff from the Orphans' Court, Clerk of Orphans' Court and Court Administration, to prepare for submission to the Board of Judges and, ultimately the State Orphans' Court Procedural Rules Committee, updated proposed local rules. Considering the complete change of format, numbering and content, coupled with a seemingly impossible deadline, the Section, the Rules Committee and Court staff undertook the Herculean effort to see the revision and submission were timely made. The excellence of these efforts was evidenced by their unanimous approval, together with the before mentioned local civil rules, at the May 19, 2016 Board of Judges Meeting.

Further, the collegiality between the Bench and the Bar is extraordinary. However, the interests of justice require that once we pass the threshold of the courtroom, all that controls is the evidence and the law. Some, but not too many, forget that Orphans' Court is a trial court bound by the facts and the law. Facts are only judicially recognized if proved pursuant to the rules of evidence, sound trial practice, and the law. That I direct counsel to appropriately employ these should be interpreted as my attempt to produce an environment where issues are heard and decided productively and fairly. In closing important issues, the

continued on page 4

REPORT OF THE CHAIR, CONTINUED

Having been both a member and Chair of the Education Committee for many years before I became an Officer, I know how rewarding Committee work can be, and I would encourage all members of the Section to get involved. We are always on the lookout for new members, and I promise you will find a warm and inviting reception.

ATTORNEY ANNUAL REGISTRATION FORM: FINANCIAL DATA REPORTING REQUIREMENTS

BY KIM D. FETROW, ESQUIRE, AND BRITTANY J. CAMP, ESQUIRE | HECKSCHER, TEILLON, TERRILL & SAGER, P.C.

I. Amendment to Pa. R.D.E. 219

Pennsylvania Rule of Disciplinary Enforcement 219 (Pa. R.D.E. 219) regarding Annual Registration of Attorneys has been amended, effective April 16, 2016, to clarify the definition of "funds of a client or a third person subject to Rule 1.15 of the Pennsylvania Rules of Professional Conduct" required to be disclosed on the Pennsylvania Attorney's Annual Fee Form (referred to in this article as "Annual Registration Form" or "Form"). These clarifications follow the amendments made to R.D.E. 219, R.D.E. 221 and Pennsylvania Rule of Professional Conduct 1.15 (Pa. R.P.C. 1.15), among others, which were approved by the Pennsylvania Supreme Court on December 30, 2014, but which have not been widely acknowledged or understood.[1] The amendments are now also incorporated into the instructions for the Annual Registration Forms due *on or before July 1, 2016*.

In light of some confusion arising out of these new requirements, particularly within the probate bar, the Legal Ethics and Professional Responsibility Committee of the Pennsylvania Bar Association just issued *Formal Opinion 2016-100*, which addresses in detail the disclosure requirements of R.D.E. 219 as they pertain to the financial data questions on the Disciplinary Board's Annual Registration Form. This Opinion will be very helpful to attorneys attempting to complete the new version of the Form for the first time.

By way of background, Pennsylvania licensed attorneys (with some exceptions) are required to file an Annual Registration Form with the Attorney Registration Office and pay the requisite annual fee by July 1st of each year in order to maintain licensure. Beginning this year, such Form must be completed and submitted online. Per R.D.E. 219(d)(1), each attorney is to provide certain required information, including information regarding accounts through which the attorney receives and holds funds of a client or third person. The amendment to subparagraph (iii) of R.D.E. 219(d)(1) specifies what is considered "funds of a client or third person subject to Rule 1.15" and largely tracks the definitions provided in R.P.C. 1.15(a)(2) and

continued on page 5

1 The authors note that taking a stroll through R.P.C. 1.15 (safekeeping property), R.D.E. 219 (annual registration of attorneys), R.D.E. 221 (funds of clients and third persons; mandatory overdraft notification), the Annual Registration Form/Instructions and the various instruction sheets and other "guidance" provided by the Disciplinary Board, the IOLTA Board and others regarding treatment of third-party funds, is not for the faint of heart. However, at least with respect to the Annual Registration Form, Formal Opinion 2016-100 and this article should provide a fairly clear roadmap for complying with the Rules. Be aware, however, that in addition to the Annual Registration reporting requirements discussed in this article, R.P.C. 1.15 also contains certain recordkeeping, accounting and other obligations regarding third-party funds, including funds held in a fiduciary capacity, that should be reviewed as well but are not addressed in this article.

A VIEW FROM THE BENCH, CONTINUED

Courtroom is as sacred as any arena which exists. I applaud the many of you who feel and act likewise.

What makes our forum unique and challenging is that we are constantly confronted with special consideration necessary where fiduciary duties or incapacities, or usually both, exist. If I am strident in dealing with the minutiae of conduct such as *ex parte* court contact, notice to parties, and the particulars of fiduciary responsibility, it is because in no other division of court are these considerations so important, if they exist at all.

Suffice it to say, I consider my present assignment to be the most intellectually stimulating, emotionally exacerbating, challenging, and fulfilling, and the Bar to be the finest and most collegial. To preside over such an excellent Bar and its fine attorneys is a pleasure and honor.

ANNUAL REGISTRATION FORM FINANCIAL REPORTING REQUIREMENTS, CONTINUED

(10) by including the following situations in which the attorney receives funds from such client or third person:

- in connection with a client-lawyer relationship;
- as an escrow agent, settlement agent, representative payee, personal representative, guardian, conservator, receiver, trustee, agent under a durable power of attorney, or other similar fiduciary position;
- as an agent, having been designated as such by a client or having been so selected as a result of a client-lawyer relationship or the lawyer's status as such;
- in connection with nonlegal services that are not distinct from legal services;
- in connection with nonlegal services that are distinct from legal services, and the attorney knows or reasonably should know that the recipient of the service might believe that the recipient is receiving the protection of a client-lawyer relationship; or
- as an owner, controlling party, employee, agent, or as one who is otherwise affiliated with an entity providing nonlegal services and the attorney knows or reasonably should know that the recipient of the service might believe that the recipient is receiving the protection of a client-lawyer relationship.[2]

If an attorney holds the funds of a client or third person subject to Rule 1.15, then R.D.E. 219(d)(1)(iii) requires the attorney to provide the following information for the period beginning on May 1st of the prior year through the date of filing: 1) the name of each Financial Institution (defined in Pa. R.P.C. 1.15(a)(4)),[3] within or outside Pennsylvania, holding such funds; 2) the name[4] and account number of each account; and 3) identification of any such account which is an IOLTA account.

In short, amended subparagraph (iii) of R.D.E. 219(d)(1) requires an attorney to report on the Annual Registration Form all bank or other investment accounts containing client or third party funds held by the law firm or the individual attorney, including such accounts held solely in a fiduciary capacity. Thus, for example, an attorney serving as executor of an estate or trustee of a trust must identify and report all of the estate's or trust's bank and investment accounts. This is true even if the attorney is serving as a fiduciary in a personal capacity (i.e., not as an attorney) for a relative such as a spouse, parent, etc. There are, however, express exceptions for funds held in an attorney's: 1) personal accounts held jointly with another, and 2) personal custodial accounts for a minor or dependent relative (unless the source of the

2 The last three categories in the definition (R.D.E. 219(d)(1)(iii)(D)-(F)) are an incorporation of the provisions of R.P.C. 5.7 related to "Responsibilities Regarding Nonlegal Services."

3 Although R.P.C. 1.15(a)(4) provides a lengthy definition for Financial Institution, and R.D.E. 219(d)(1) invokes the definition in subparagraph (iii) (which requires the name of the "Financial Institution" as defined in Rule 1.15(a)(4)) but not in subparagraph (iv) (which requires the name of the financial institution, whether or not such institution qualifies as a Financial Institution under R.P.C. 1.15(a)(4)), the distinction from the authors' perspective is not necessary and just creates confusion with respect to the reporting of accounts other than the attorney's traditional trust accounts. As a reminder, "Trust Accounts" by definition hold Rule 1.15 Funds in an account in an Eligible Institution, which is in turn defined as a "Financial Institution" approved as a depository of Trust Accounts pursuant to R.D.E. 221(h). However, funds held in a fiduciary capacity need not be held in an Eligible Institution or even in a Financial Institution as they are permitted to be held in a Trust Account "or in another investment or account which is authorized by the law applicable to the entrustment or the terms of the instrument governing the Fiduciary Funds." Pa. R.P.C. 1.15(l). In short, for reporting Rule 1.15 Funds held in a fiduciary capacity, an attorney may simply list the financial institution in which the account is held without worrying about the definitions.

4 Note, however, that although R.D.E. 219 requires the "name" of the account to be reported, the Annual Registration Form itself does not require a name (the Form provides only "fill-in" boxes for such accounts, and there is no such box in which to designate the actual name on the account).

continued on page 6

funds is not the attorney or his or her spouse).[5]

In addition to the requirements set forth in subparagraph (iii), subparagraph (iv) of R.D.E. 219(d)(1), which was added in the prior round of amendments in 2014, provides a "catch all" requiring any accounts holding funds of a client or third person, which are not reported under R.D.E. 219 (d)(1)(iii), to be reported (for May 1st of the prior year through the date of filing) if the attorney:

- had sole or shared signature authority, or
- authorization to transfer funds to or from such account.

The attorney must provide the following information for each account reported pursuant to this subparagraph (iv): 1) the name of the financial institution (whether or not such institution qualifies as a Financial Institution under R.P.C. 1.15(a)(4))[6]; 2) location; and 3) account number.

Subparagraph (iv) of R.D.E. (219(d)(1)(iv)) pulls in situations not covered by subparagraph (iii), such as where an attorney is delegated signing or transfer authority over an account in his or her capacity as an attorney or fiduciary, but because the attorney does not actually receive or hold the funds, would otherwise not be reportable. For example, an attorney serving in his or her personal capacity as treasurer for a charitable organization where he or she is a signatory on the account for the organization or otherwise is authorized to transfer funds into or out of such account to report such account on the Annual Registration Form. Subparagraph (iv) would also presumably require the reporting of accounts opened in an Attorney Fiduciary Services system, such as that at BNY Mellon, even if the lawyer is not the fiduciary because the attorney is designated as an authorized signer on the account.

What if the attorney is a co-fiduciary? Comment 6 to R.P.C. 1.15 clearly states that funds controlled by a "non-lawyer professional co-fiduciary" are not considered Rule 1.15 funds. Nonetheless, as described above, subparagraph (iv) of R.D.E. 219(d)(1) requires reporting of certain non-Rule 1.15 Funds and thus appears to require such an account to be reported on the Annual Registration Form if the attorney co-fiduciary has signing or transfer authority over the account. If your co-fiduciary is a non-professional, there is no exception; the fiduciary accounts are considered Rule 1.15 Funds and should be reported under subparagraph (iii) of R.D.E. 219(d)(1).

The exceptions for joint personal accounts and certain custodial accounts for minor or dependent relatives provided in the notes to subparagraph (iii) also appear to apply to subparagraph (iv).

II. Attorney Annual Registration: The Unified Judicial System of Pennsylvania Web Portal

All attorneys are required to file their Annual Registration Form online this year. The provisions of R.P.C. 1.15 and R.D.E. 219 are intended to be incorporated into the Form itself. The Form provides two subsections for accounts to be listed, one for IOLTA or IOLTA Exempt accounts and a second for "Interests for Clients, Other Authorized Investments or Business/Operating" accounts.[7] The first subsection appears to address the attorney's traditional IOLTA accounts and should present nothing new for the practitioner. It is the next section "Interest for Clients, Other Authorized Investments or

5 Under the Rule, an UTMA account held by an attorney as custodian is not excluded (and thus must be reported) if such account was funded by someone other than the attorney, such as a grandparent of the attorney's child.

6 See footnote 3 above.

7 An account is "IOLTA exempt" only in the limited instance that the attorney has applied for and received a special exemption pursuant to Pa. R.P.C. 1.15(n).

continued on page 7

ANNUAL REGISTRATION FORM FINANCIAL REPORTING REQUIREMENTS, CONTINUED

Business/Operating" accounts where the attorney's fiduciary-held (or authorized signatory) accounts would be listed. This section of the Form requires the attorney to enter the following information for each account:

- Eligible Institution Type: bank or brokerage;
- Bank/Brokerage Name,
- Account Number,[8]
- Identifying whether the account "Holds PA.R.P.C. 1.15 Funds",
- Bank Location (State), and
- Account Type: "interest for clients", "other authorized investments" or "business/operating".

Be aware that the Form and its instructions are not entirely consistent with what the Rules, as described above, actually require an attorney to report. For example, the definition of R.P.C. 1.15 Funds provided directly on the Form appears to be limited to an account "established to hold client/third party funds *related to the practice of law in Pennsylvania*" (emphasis added). This is likely to cause confusion for attorneys completing the Form, stating "yes" or "no" to the "*Holds PA.R.P.C. 1.15 Funds" option, for accounts where the attorney is acting in a fiduciary capacity and not related to the practice of law. The authors recommend that the attorney report the accounts as required in the actual Rules described above, and thus identify third-party funds held as a fiduciary, even if not related to the practice of law, as "1.15 Funds" for such fiduciary accounts that are reportable under R.D.E. 219(d)(1)(iii).

Likewise the term "Eligible Institution," although a defined term, is not used in the second subsection of the Form in a way that makes sense. The Form asks what type of "Eligible Institution" the account is located in, the two options being a bank or brokerage account. "Eligible Institution," however, is defined in Rule 1.15 as "a Financial Institution which has been approved as a depository of Trust Accounts pursuant to Pa. R.D.E. 221(h)." Of course funds an attorney holds as a fiduciary are not typically held within "Trust Accounts" but instead are "Fiduciary Funds" which may be placed in a Trust Account or "in another investment or account which is authorized by the law applicable to the entrustment or the terms of the instrument governing the Fiduciary Funds" and therefore are not subject to the "Eligible Institution" limitations. The authors recommend ignoring the term "Eligible Institution" and simply list all accounts required to be reported under the Rules as described above, designating the actual financial institution in which the account is located, whether or not it is an Eligible Institution.

Finally, the requirement in the second subsection of the Form to identify the "Account Type" provides the option of "interest for clients", which is undefined in the Rules or on the Form itself. Distinguishing between "interest for clients" and "other authorized investments" is not so straightforward given R.D.E. 219's expanded definition of "funds of a client or third person subject to Rule 1.15". Although not clear, based on the language in R.P.C. 1.15(l), the authors conclude that all non-IOLTA accounts within the definition of Trust Accounts under the Rules (even if containing Fiduciary Funds) be identified as "interest for clients" accounts and all other accounts in which a lawyer holds reportable client or third-party funds be identified as "other authorized investments".

8 As of the publication date of this article, the authors note that the electronic Annual Registration Form will not accept letters in the account number box. For some institutions, the letter designations may be the only distinction between separate trust accounts under the same governing document. Thus, upon entering the numbers only, the online system may not accept the registration because of what will appear to be duplicate entries. The Disciplinary Board's suggested solution for this year's registration is to file those accounts with "number only" account numbers on the on-line system, then fax a supplemental filing to the Board with the "mixed number letter" account numbers.

continued on page 8

ANNUAL REGISTRATION FORM FINANCIAL REPORTING REQUIREMENTS, CONTINUED

III. Additional Guidance

The Disciplinary Board of the Supreme Court of Pennsylvania provides some materials on its website, compiled by the IOLTA and Disciplinary Boards (collectively, the" Boards") to assist attorneys in completing their Annual Registration Forms in accordance with the applicable rules. A "Financial Data Frequently Asked Questions" link (available at http://www.padisciplinaryboard.org/documents/financial-data-help.pdf) refers an attorney to a Financial Data Reference Table, which categorizes the account types and provides a reference to applicable rules and regulations for each, as well as a list of Frequently Asked Data Questions with answers from the Boards.

The IOLTA Board provides additional information on the Attorney Compliance page of its website entitled "Attorney Guidance" (available at https://www.paiolta.org/attorney-compliance/handling-funds-of-others/#the-duty-of-notice), which discusses more fully the handling of funds for others as required by R.P.C. 1.15.

Finally, as noted above, the Legal Ethics and Professional Responsibility Committee of the Pennsylvania Bar Association has recently issued Formal Opinion 2016-100 (available at http://www.pabar.org/pdf/PBA%20Formal%20Ethics%20Op%202016-100.pdf) addressing the financial data questions on the Annual Registration Form and the disclosures required by R.D.E. 219.

JOIN A COMMITTEE

The Section's Committees depend on the steady flow of people, energy and ideas. Join one!
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ETHICS COLUMN

BY TIMOTHY J. HOLMAN, ESQUIRE | SMITH KANE HOLMAN, LLC[1]

What ethical considerations are involved when advising your client about her social media presence?

It goes without saying that the rise of social media platforms such as Facebook, Instagram, Twitter, and LinkedIn have fundamentally changed the way we communicate as a society. But must social media change the way we communicate with our clients? Yes, and if you fail to apprise yourself of how social media sites work and how those sites affect your clients, you may not be providing competent representation to your clients.

During your client intake process, you should ask about and understand your client's social media presence so that you can appropriately advise your client. The Philadelphia Bar Association Professional Guidance Committee addressed this issue in Opinion 2014-5, in which it opined that "in order to provide competent representation in accordance with Rule 1.1 [Competence], a lawyer should (1) have a basic knowledge of how social media websites work, and, (2) advise clients about the issues that may arise as a result of their use of these websites."

Ethics Opinion 2014-5 also states that "[a] lawyer may instruct a client to make information on [a] social media website 'private,' but may not instruct or permit the client to delete/destroy a relevant photo, link, text or other content, so that it no longer exists."

So, let's assume you view your new client's Facebook profile and see an old picture of your client and her now-deceased mother in the Cartier store holding up matching watches they just purchased. Your client acted as her mother's Agent under Power of Attorney and now your client's brother, the Executor of the mother's estate, has compelled your client to file an Account of her Agency, suspecting that your client wasted the mother's money on all kinds of things, including jewelry. What advice can you give your client about that photograph displayed on Facebook?

According to the Philadelphia Bar Association Ethics Opinion 2014-5, you can advise your client to change her Facebook privacy settings to restrict access to the photograph, and you can also advise her to remove the photograph from her Facebook profile. You cannot, however, instruct your client to alter, destroy or conceal any relevant information. Therefore, according to the Philadelphia Bar Association, if you advise your client to remove the photograph from her Facebook page, you must also take the necessary steps to preserve that photograph because it may later prove to be relevant and discoverable.

But wait. You may ask yourselves whether advising a client to remove a photograph from Facebook violates Rule of Professional Conduct 3.4(a), which states, "A lawyer shall not unlawfully obstruct another party's access to evidence or unlawfully alter, destroy or conceal a document or other material having potential evidentiary value or assist another person to do any such act." Does removing the photograph from Facebook constitute concealment of the photograph in violation of Pa. R.P.C. 3.4?

According to the Philadelphia Bar Association and the Pennsylvania Bar Association (Formal Opinion 2014-300), advising a client to remove a photograph or other social media information from Facebook does not violate Pa. R.P.C. 3.4. In the hypothetical described above, because the client is engaged in litigation about her conduct as Agent, the attorney obviously has a duty to preserve the photograph, even if the attorney advises the client to remove it from social media. If the photograph

continued on page 10

1 Special thanks to Daniel R. Boose, Esquire for his assistance in the preparation of this column.

ETHICS COLUMN, CONTINUED

is later responsive to a discovery request, the client will have to produce the photograph and it makes no difference whether the client removed the photograph from social media or subjected it to more restrictive privacy settings.

In other words, advising your client to change her privacy settings and/or to remove a photograph from social media does not shield your client's social media presence from your adversary. Although an attorney can and should properly advise a client to stop broadcasting damaging information to the world via a social media account, that damaging information is still subject to your adversary's discovery requests.

Finally, although you cannot change what your client previously made public in her social media accounts, this fiduciary litigator recommends advising your client against putting any information about her case on social media, and even warning your client about her social media accounts when addressing attorney/client confidentiality in your engagement letter. By preemptively advising your client about her social media presence, you may avoid privilege issues later in your representation.

With that, I will leave you to brush up on your social media knowledge so that when your next client comes to you and says that he has Snapchat, Vine and Instagram accounts, you will know exactly how to advise him.

HAVE IDEAS OR TOPICS FOR AN ETHICS COLUMN?

Send your questions and ideas to:

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TAX UPDATE

BY MARGERY J. SCHNEIDER, ESQUIRE | ROSENN JENKINS & GREENWALD, LLP

FEDERAL ESTATE TAX

IRS Form 8971 Filing Deadline

Notice 2016-27, March 23, 2016

In its Notice 2016-27, the IRS extended the deadline for the filing of Form 8971 and Statement A under IRC Section 6035 by executors and other persons until June 30, 2016. These forms establish for federal estate tax purposes the valuation and basis of property acquired from a decedent.

New Basis Reporting Requirements

Proposed Regulations REG-127923-15, March 4, 2016

The proposed regulations provide guidance concerning the new basis reporting requirements imposed under IRC §§ 1014(f) and 6035, which mandate that a recipient's basis in property acquired from a decedent be consistent with the value of the property as finally determined for Federal Estate Tax purposes.

Family Limited Partnerships

Estate of Holliday

TC Memo 2016-51 (March 17, 2016)

The Tax Court ruled that $4 million in assets transferred to a family limited partnership must be included in a decedent's estate under I.R.C. Section 2036 because the decedent maintained control of the funds after the transfer and there was no legitimate non-tax reason for the creation of the FLP.

The Holliday family formed a family limited partnership (FLP) in November 2006, for the purpose of acquiring interests in business and property. The FLP was created by decedent's sons three years after she was moved to a nursing home. The capital contribution to the FLP consisted solely of $5.9 million in marketable securities transferred from the decedent's account. The decedent held an 89.9% limited partnership interest in the FLP until her death in January 2009. On the same day as the marketable securities were contributed to the FLP, the decedent sold all of her membership interests in the LLC that held a 0.1% general partnership interest to her sons and gifted a 10% partnership interest to an irrevocable trust. Decedent's Estate claimed a 40% combined discount on her federal estate tax return.

The IRS claimed that, under IRC Section 2036(a)(1), both the 0.1% general partnership interest and the 10% limited partnership interest should be included in the decedent's gross estate, in addition to the undiscounted value of the remaining 89.9% limited partnership interest.

The Tax Court agreed with the IRS, finding that the decedent retained use and enjoyment of the property because the partnership agreement provided for the regular distribution of cash to partners but did not make such distributions, and there was an implied agreement allowing the decedent to make use of the funds transferred to the FLP. Partnership formalities were not observed in deciding whether to make distributions and the assets were not actively managed. The only real reason for the creation of the FLP was to avoid transfer taxes after the decedent's death by taking advantage of the valuation discounts afforded by FLPs.

The Tax Court agreed with the IRS in finding no evidence of the three non-tax reasons claimed by the Estate for the formation of the FLP, which were (1) protection of the assets from litigator's claims; (2) protection from undue influence on the part of caregivers, and (3) the necessity of an FLP to manage and preserve decedent's assets. The Court countered each reason: (1) it ruled that the asset protection arguments were not effective because decedent maintained a significant amount of assets outside the FLP and in any case was unlikely to be sued; (2) it noted that protection from the undue influence of caregivers was not an issue because the decedent's sons

continued on page 12

managed her financial affairs and that this reason was not brought up at the time of the formation of the FLP; and (3) an FLP was not a necessary entity for the management of the decedent's assets, as demonstrated by the fact that the assets of her deceased husband were all managed in trusts without difficulty.

FEDERAL GIFT TAX

Split-Dollar Life Insurance Premium Payments

Estate of Morrissette v. Commissioner

146 T.C. No. 11 (April 13, 2016)

In a precedential decision, the Tax Court ruled in favor of the taxpayer, on partial summary judgment, that an intergenerational split-dollar life insurance arrangement involving a lump-sum life insurance premium payment made by the revocable trust of a member of a senior generation to insure one or more members of a junior generation is not a taxable gift to the extent that the premium payment exceeds the value of current life insurance protection, and that the value of the current life insurance protection is determined using the economic benefit regime set forth under Treasury Regulations Section 1.61-22.

The three sons of Arthur E. Morrissette Sr. and Clara M. Morrissette, heirs to the Interstate Van Lines fortune, had petitioned the Tax Court claiming that the IRS erred in determining that they had failed to report gifts to their trusts from other trusts in 2006 and assessing accuracy-related penalties of $2.76 million and $4.42 million.

In 2006, the conservator for 93-year old Clara M. Morrissette had advanced a total of almost $30 million from her revocable trust to dynasty trusts established for each son in order to pay life insurance premiums insuring each of the sons. Upon the death of each son, the life insurance policies would pay out to the trusts of the surviving sons to fund buy-sell agreements to acquire the stock of the family business held by or for the benefit of the deceased sibling. Also, Clara's trust retained the right to a portion or all of the life insurance policy payouts. The IRS argued that the split-dollar loans, which were payable upon the death of the respective son, were loans that should be considered assets of Clara's estate.

During the three years prior to her death in 2010, Clara reported gifts to the dynasty trusts as determined using the economic benefit regime using IRS Table 2001 issued by the Internal Revenue Service. When she died in 2010, the estate reported the total value of the receivables owned by her Estate under the split-dollar arrangements as $7.5 million. Claiming that the Estate had failed to report total gifts of $29.9 million, the IRS issued a notice of deficiency for a gift tax liability and an IRC Section 6662 penalty for tax year 2006, asserting that the estate failed to report taxable gifts of $29.9 million. Alternatively, the IRS characterized the split-dollar life insurance arrangements as loans under Treas. Regs. Section 1.7872-15(a)(2)(i)

The brothers disagreed, noting Clara's trust always retained the right to a portion or all of the life insurance policy payouts.

The Tax Court rejected the following arguments made by the IRS:

- That the trusts benefitting the sons conferred an additional economic benefit to the sons. The IRS claimed that the sons had a direct or indirect right in the cash values of the insurance policies because an amendment to Clara's trust stated that the cash values would pass to the sons' trusts after her death. The Court countered that because Clara's trust was a revocable trust, any rights that the sons' trusts had were not legally enforceable.

- That the arrangement was a "reverse split dollar" arrangement under Notice 2002-59. The Court disagreed because this arrangement used Table

continued on page 13

UN-BUNDLING THE DETAILS OF THE FINAL REGULATIONS UNDER SECTION 67

The Deductibility of Trust and Estate Expenses

BY MARGUERITE C. WEESE, J.D., LLM (TAX) | VICE PRESIDENT, WILMINGTON TRUST, N.A.

Background

The issue of the deductibility of investment related, trust and estate expenses is not a new one; it has been the center of court cases for over two decades. In the early 2000s, the Circuit Courts split on the correct way to read Internal Revenue Code (IRC) Section 67, so the Internal Revenue Service (IRS) issued proposed regulations in 2007, which followed the Second Circuit's approach allowing a full deduction for costs unique to an estate or trust. It was in these proposed regulations that we first learned about the concept of unbundling fees. In an effort to prevent taxpayers from bundling fees that were subject to the 2% floor with fees that were not and then fully deducting the entire amount, the rule stated that fiduciaries would be required to allocate bundled fees using any reasonable method. This rule, however, applied until the Supreme Court decision in *Knight v. Commissioner*, 552 U.S. 181 (2008).

Michael Knight was the Trustee of the William Rudkin Testamentary Trust. As Trustee, Knight hired an investment firm to invest the trust's assets. The trust, in turn, deducted the full amount of the investment advisory fees paid to the firm on the trust's fiduciary income tax return. The IRS stated that this fee was a miscellaneous deduction and, therefore, would only be deductible to the extent the fee exceeded 2% of the trust's adjusted gross income according to IRC section 67(e). Knight challenged this decision, and the case made its way through the court system, eventually reaching the Supreme Court. The Court examined the issue in terms of whether an individual would incur such investment advisory fees and, in 2008, held that if it was common for an individual to incur such a cost, then the deductibility of that cost would be subject to the 2% floor. The Court went on to state that some investment advisory fees incurred by a trust may be fully deductible if the fees were unique to a fiduciary account. The Court explained this by reasoning that it is possible for a trust to have an unusual objective or require specialized attention.

In response to *Knight*, the IRS stated that it would publish regulations that were consistent with the Supreme Court's analysis, so in 2011 the 2007 proposed regulations were withdrawn and new proposed regulations were issued. These regulations provided that an expense would be subject to the 2% floor, to the extent the expense was commonly or customarily incurred by a hypothetical individual holding the same property. In 2014, the proposed regulations were issued as final with only a few, relatively minor modifications.

The 2014 Final Regulations

In May 2014, the IRS issued final Treasury Regulation Section 1.67-4. The regulation provides that an expense is subject to the 2% floor if:

continued on page 14

TAX UPDATE, CONTINUED

2001 as a measure of the economic benefit, not Table PS 58.

- That the premiums paid by the donor trust were prepayments of future payments.

The Court also held that the question of whether additional economic benefits other than the cost of the current life insurance protection are provided to the junior generation is a purely legal question and does not involve triable issues of fact. It could therefore be decided by summary judgment. The Court declined to decide "whether the estate's valuation of the receivables … in the gross estate is correct."

1. it is included in the definition of miscellaneous itemized deductions under section 67(b);

2. it is incurred by an estate or non-grantor trust; and

3. it commonly or customarily would be incurred by a hypothetical individual holding the same property.

The regulations do not define the term "commonly or customarily," but provide instances of fees that are not commonly or customarily incurred by individuals. The regulations also provide a non-exhaustive list of certain expenses that are commonly or customarily incurred by individuals.

- Ownerships Costs: Regulation section 1.67-4(b)(2) provides that costs that are incurred simply by reason of being an owner of the property are subject to the 2% floor. Examples of this expense would be condominium fees, insurance premiums, automobile registration, etc.

- Tax Preparation Costs: Regulation Section 1.67-4(b)(3) provides that tax preparation fees included in an exclusive list are not subject to the 2% floor. This list includes costs relating to all estate and generation-skipping transfer tax returns, fiduciary income tax returns, and the decedent's final individual income tax return. The costs of preparing all other tax returns, for example, gift tax returns, are subject to the 2% floor.

- Investment Advisory Fees: Regulation section 1.67-4(b)(4) provides guidance and examples related to investment advisory fees incurred by the estate or trust. Fees for investment advice are typically subject to the 2% floor, except to the extent the fees exceed what is charged to a normal individual investor. Similarly, the cost of providing specialized advice relating to an unusual investment objective or the need for customized balancing of interests of various parties is fully deductible to the extent the cost exceeds that which is charged to a hypothetical individual, including an individual that might require highly specialized advice.

- Appraisal Costs: Regulation section 1.67-4(b)(5) specifically includes a list of appraisal costs that are not subject to the 2% floor: costs in connection with determining fair market value of assets as of the decedent's date of death for purposes of making distributions from a trust or estate or for purposes of preparing the trust's or estate's tax return, including generation-skipping transfer tax returns. Any appraisal costs not specified in this section are subject to the 2% floor.

- Fiduciary Expenses: Regulation section 1.67-4(b)(6) exempts from the 2% floor certain fiduciary fees that are not commonly incurred by an individual, such as probate court fees and costs, fiduciary bond premiums, and the costs of providing legal notices to creditors or heirs.

Bundled Fees

A "bundled fee" is a single fee, commission, or other expense for both costs that are subject to the 2% floor and costs that are not. They are frequently encountered with respect to fiduciary fees or attorney and accountant fees. The final regulations require that bundled fees must be allocated between costs that are subject to the 2% floor and those that are not, except:

- Non-Hourly Fees: Regulation section 1.67-4(c)(2) states that bundled fees

continued on page 15

that are not computed on an hourly basis need only be allocated between investment advice and all other services. The portion attributable to investment advice is subject to the 2% floor and the remaining balance is fully deductible.

• Separate Payments: Any payments made from the bundled fee to third parties that would have been subject to the 2% floor if paid directly by the trust or estate are still subject to the 2% floor. Any payments separately assessed by the fiduciary, such as out of pocket expenses billed to the estate or trust, in addition to the usual bundled fee, are subject to their own analysis to determine if they would be commonly incurred by an individual and, thus, subject to the 2% floor.

Reasonable Allocation

The regulations also allow for any reasonable method for such allocation to be made and include a non-exclusive list of factors that may be considered in determining whether an allocation is reasonable. These factors are:

• the percentage of the value of the trust subject to investment advice;

• whether a third party advisor would have charged a comparable fee for similar advisory services; and

• the amount of the of the fiduciary's attention to the trust or estate that is devoted to investment advice as compared to dealings with beneficiaries and distribution decisions and other fiduciary functions.

What the final regulations do not provide is a safe harbor method for allocating bundled fees, so fiduciaries have to exercise their judgment in developing a reasonable method of allocation. The IRS has, however, reserved the right to provide safe harbors in future guidance.

These final regulations became effective on January 1, 2015, so it is important that fiduciaries evaluate whether their current practices with respect to fee allocation and unbundling fees satisfy the new rules. Since the guidance on what constitutes a reasonable method of allocating bundled fees is light, it is important for a fiduciary to focus on developing a method to use unilaterally across accounts, such as beginning to record the time a fiduciary spends on investment and non-investment tasks, or creating a new fee schedule which identifies investment and non-investment fees separately.

NOTE THIS!

The New Jersey Legislature has passed the Uniform Trust Code, effective as of July 16.

Be sure to look for more information in the next issue of the Probate and Trust Law Section newsletter.

CASE SUMMARY FROM THE ORPHANS' COURT LITIGATION COMMITTEE[1]

Estate of McAndrew, *131 A.3d 988 (Pa. Super. 2016)*

BY ADAM T. GUSDORFF, ESQUIRE | HECKSCHER, TEILLON, TERRILL & SAGER, P.C.[2]

In a case of first impression, the Pennsylvania Superior Court recently determined that a verdict of guilty but mentally ill for first-degree murder bars the killer from inheriting from the victim's estate under the Slayer's Act, 20 Pa. C.S. §§ 8801-8815.

In *McAndrew*, the appellant was Joseph McAndrew ("Joseph"), who killed his father, brother and mother in 2011. Following a bench trial, the trial court found Joseph "guilty but mentally ill" on three counts of first-degree murder and sentenced him to three consecutive terms of life imprisonment, without parole. The court recommended that Joseph receive psychiatric treatment. *Estate of McAndrew*, 131. A.3d at 989.

Joseph's mother, Susan, was deemed to survive Joseph's father and brother, and left a net estate of about $840,000. Susan's intestate heirs were her father and Joseph. Susan's administratrix filed an accounting with the Orphans' Court of Montgomery County and, following completion of the criminal proceedings, the Orphans' Court held that Joseph was a "slayer" who was prohibited from inheriting from Susan. Through a Guardian ad litem, Joseph filed exceptions to the adjudication and, following oral argument, the Orphans' Court denied and dismissed the exceptions. *Id.* Joseph thereafter appealed to the Superior Court through the ad litem.

The sole question on appeal, which the parties agreed presented a case of first impression, was whether the Slayer's Act prohibits an individual who was found guilty but mentally ill of homicide from inheriting the victim's estate. *Id.*

The Superior Court began its analysis with a review of the Slayer's Act, which defines a "slayer" as "any person who participates, either as a principal or as an accessory before the fact, in the willful and unlawful killing of another person." *Id.* at 990 (citing 20 Pa. C.S. § 8801). Fundamentally, the Slayer's Act provides that "[n]o slayer shall in any way acquire any property or receive any benefit as the result of the death of the decedent … ." 20 Pa. C.S. § 8802. Instead, the slayer is deemed to have predeceased the victim/decedent. *Id.* § 8803. A slayer is specifically barred from receiving an intestate share of the victim's estate. *Id.* § 2106(c). The Slayer's Act is to be "broadly construed to effect the policy of this State that no person shall be allowed to profit from his own wrong, wherever committed." *Id.* § 8815.

The Superior Court concluded its review of the Slayer's Act by citing case law for the proposition that a conviction for murder or voluntary manslaughter "acts as a conclusive bar to the slayer receiving any benefit from the victim's estate." *McAndrew*, 131 A.3d at 990 (citing *In re Kravitz's Estate*, 211 A.2d 443 (Pa. 1965) (murder); *In re Klein's Estate*, 378 A.2d 1182 (Pa. 1977) (murder); and *In re Estate of Bartolovich*, 616 A.2d 1043 (Pa. Super 1992) (voluntary manslaughter)).

The Court then turned to the Crimes Code to consider the differences between verdicts of "not guilty by reason of insanity" and "guilty but mentally ill." *Id.* at 991-92. Citing its own decision in *Commonwealth v. Trill,* 543 A.2d 1106, 1127-28 (Pa. Super. 1988), the Court noted that there is a three-step analysis. The first step is to determine whether the Commonwealth has proved each element of the crime beyond

1 The Orphans' Court Litigation and Dispute Resolution Committee will provide summaries of recent litigation cases in each quarterly newsletter.

continued on page 18

CASE SUMMARY, CONTINUED

a reasonable doubt. If so, the next step is whether the defendant proved by a preponderance of the evidence that he was insane at the time of the killing. If he meets that burden, then he must be acquitted. If the defendant cannot prove insanity, he can obtain a verdict of guilty but mentally ill if the fact finder concludes that the facts establish beyond a reasonable doubt that as a result of mental disease or defect, the defendant lacks substantial capacity to appreciate the wrongfulness of his conduct or to conform his conduct to the requirements of the law.

The Court observed that, in this case, the Commonwealth proved the elements of first-degree murder beyond a reasonable doubt, Joseph failed to prove by a preponderance of evidence that he was insane at the time of the murders, and the fact-finder (i.e., the trial court) determined that Joseph was mentally ill. *Id.* at 992. The critical fact was that Joseph was found guilty of first-degree murder. While the "guilty but mentally ill" verdict entitles Joseph to greater access to mental health treatment while he is incarcerated, it does not convert the guilty verdict into a successful insanity defense. *Id.*

Following its review of the underlying law, the Court considered whether Joseph was prohibited from inheriting from his mother under the Slayer's Act. In doing so, the Court relied heavily on an Orphans' Court decision in which the Slayer's Act was applied to prevent a person who was guilty but mentally ill from receiving the proceeds of the decedent's life insurance policy. *Id.* at 992-93 (discussing *Prudential Insurance v. Roberts,* 8 Fid. Rep. 2d 309 (C.P. Westmore. 1988)).

The following portions of Roberts were particularly persuasive:

The verdict of guilty but mentally ill was created by statute in 1982: 18 Pa. C.S. [] § 314. Its intended effect was not to excuse criminal conduct as is the case where a defendant is found not guilty by reason of insanity; rather, the legislature provided that a person found guilty but mentally ill "may have the same sentence imposed upon him which may be lawfully imposed on any defendant convicted of the same offense." 42 Pa. C.S. [] § 9727. The act does not in any way reduce the defendant's culpability for his or her act nor in any way does it negate the element of intent or willfulness normally required for conviction. The only difference is that at sentencing the court may, after a finding that the defendant is severely mentally disabled and in need of treatment, order the defendant to serve some of all of the sentence imposed in treatment pursuant to the "Mental Health Procedures Act" 42 Pa. C.S. [] § 9272(a) and (b).

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[W]e conclude that a guilty but mentally ill verdict where the defendant has been convicted of murder does not diminish the legal sanctions which may come to bear on the person convicted. Among the sanctions which follow a murder conviction is the civil disability imposed upon the convicted person under the Slayer's Act.

Id. at 992-93 (quoting Roberts, 8 Fid. Rep. 2d at 310).

The Superior Court found that the Montgomery County Orphan's Court had properly applied the "sound reasons in the Roberts court's persuasive decision." *Id.* at 993. Accordingly, it affirmed and held that "a verdict of guilty but mentally ill for first-degree murder bars a killer from inheriting from the decedent's estate under the Slayer Act." *Id.* In a concluding footnote, the court observed that, in a separate matter involving an insurance policy on Joseph's father's life, the Eastern District of Pennsylvania also had determined in an unpublished decision that Joseph was a slayer under Pennsylvania law. *Id.* at 993, n.6.